



NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

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**EX PARTE**

January 11, 2005

Jonathan Cody  
Legal Advisor, Office of Chairman Michael Powell  
Federal Communications Commission  
445 12th Street, S.W.  
Washington, D.C. 20554

**Re: CS Docket No. 97-80**

Dear Mr. Cody:

On December 20, 2004, we responded to various assertions embodied in recent ex parte submissions by the Consumer Electronics Association ("CEA") and others. CEA's reply of December 21, 2004, as well as some claims in its letter of December 17, 2004, warrant an additional response.

At the outset, we note some disappointment with the tenor of these recent filings. CEA disregards the substance of NCTA's December 20 letter; and its conclusory statements add little to the Commission's deliberative process. Its mischaracterizations of NCTA's arguments (e.g., "patently wrong," "grossly misleading," and "a total fallacy") do not help to illuminate the issues to be decided. CEA's portrayal of the cable industry's behavior over the past several years is inaccurate and inconsistent with the amicable environment in which the one-way and two-way negotiations have been and are being conducted by CEA and NCTA member companies. It is also at odds with the enormous changes that have taken place in cable operators' growing, mutually beneficial relationships with consumer electronics manufacturers and retailers.

We now address each claim separately.

1. CEA: *"NCTA's assertions that the costs associated with the separate security requirement will remain high are patently wrong. The 'licensing, warranties and indemnification, and underlying security' costs that they cite are common to both renewable and hardwired security. NCTA's arguments that these costs are borne only by the cable industry are grossly misleading."*

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Here, CEA has ignored a number of the points that we made in NCTA's December 20 letter and misunderstood or mischaracterized others. First, we cited "licensing, warranties and indemnification, and underlying security" costs to explain that CableCARD costs are not limited to the manufacturers' "bill of materials" for the hardware alone, and we noted that "governmental coercion of cable operators to purchase enormous volumes of CableCARDS from a small subset of manufacturers . . . would create no new downward pressure on pricing" of these software costs. Second, we pointed out that, *even using the CE industry's estimates of CableCARD costs*, the Integration Ban will cost cable companies hundreds of millions of dollars in additional equipment costs, and we further noted that the CE estimates ignore the additional "Host" side costs. Third, we pointed out that these additional costs are not faced by cable's DBS competitors (with whom some of CEA's members are closely aligned). CEA has no answer for any of these points.

Instead, CEA's retort only reinforces the point NCTA made. One certainly should expect to incur costs associated with licensing, warranties and indemnification, and underlying security of a device that uses renewable security, or any other device that provides conditional access authorization. That is our point. Such non-hardware costs illustrate the many costs that CEA has been ignoring in its hypothesized cost reduction for CableCARDS. Moreover, CEA offers no reason to believe that such costs will be as high in the case of renewable security as they are in the case of today's CableCARDS (and associated Host-side interface), where cable operators are limited in the number of manufacturers of CableCARDS.

Of course costs associated with licensing, warranties, and indemnification are part of the cost of providing conditional access authorization of any type. But that does not mean, as CEA seems to imply, that those costs – like hardware costs – will be reduced over time. Nor does it mean, as CEA appears to suggest, that there is no cost to the consumer of mandating separated security in leased set-top boxes.

Finally, we are not sure what CEA means when it says NCTA raised "grossly misleading" arguments that these costs are borne only by the cable industry. We did not highlight that argument, but perhaps we should have because it is true. We did point out that these additional costs are not faced by cable's DBS competitors (with whom some of CEA's members are closely aligned). Today, DBS is exempted from the rule, does not incur this cost, and can innovate rapidly. SBC, now on an aggressive multi-channel video build-out, also considers itself exempt and is deploying proprietary set-top boxes. In this intensely (and increasingly) competitive environment, cable operators should not be required to divert the development dollars and resources that should be going into new features and new services to a set-top engineering redesign that provides no consumer benefit and only adds to consumer cost.

2. CEA: *"Further, the argument that leased set-top boxes are leased at government-mandated prices is a total fallacy. Cable companies can and do charge whatever prices they choose."*

This assertion by CEA is inexplicable. It is undeniable that cable set-top boxes are price-capped by government mandate. Section 623(b)(3) of the Communications Act and Section 76.923 of the Commission's rules specifically subject leased set-top boxes, including those that are "addressable" and receive premium services, to cost-plus rate regulation.<sup>1</sup> These rules plainly require (with few exceptions) that cable equipment be leased at cost plus a government-specified margin; if costs go up because of a government-imposed Integration Ban, so too will lease rates to consumers. This will effectively be a "tax" on cable customers with no accompanying benefit since leased boxes do not leave the franchise area and portability is the key benefit of using separate security modules in "Digital Cable Ready" equipment.

3. CEA: *"The notion that cable MSOs will suddenly have to switch-out their entire fleets of set-top boxes, even though the regulation explicitly gives them the right to keep existing devices in service, also is unsubstantiated."*

NCTA never argued that "MSOs will suddenly have to switch-out their entire fleets of set-top boxes." Our point was that the numbers of set-top boxes that would be affected by the Integration Ban are very substantial, even over the "short-term alone." This is not because there would an *immediate* switch out of *all* existing set-top boxes. Rather, as we explained in our December 20 letter (at note 6), this would result from rapid growth in the number of newly-deployed set-top boxes *plus* replacement of "existing integrated boxes . . . by CableCARD-enabled boxes."

There is a growing demand for digital set-top boxes as consumers come to value new services that cable has made available (tiers of digital programming, specialty tiers, interactive electronic program guides with powerful parental controls, high-definition television programming, etc.).<sup>2</sup> The Kagan data we provided project an increase in

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<sup>1</sup> See *Rate Regulation, First Report and Order*, 8 FCC Rcd 5631 at ¶283 (1993) ("the statute specifically included addressable converter boxes needed to access video programming on a per program or per channel basis. . . . Congress included equipment and installation in the definition of cable programming services to prevent cable operators from avoiding regulation of equipment, if any, used to provide cable programming services alone or in conjunction with unregulated services."); *Rate Regulation, First Order on Reconsideration*, 9 FCC Rcd 1164 at ¶¶41-42 (1994) ("We further observe that Congress intended that our regulations establish equipment rates similar to those that would exist in a competitive environment. Under the 'actual cost' standard, cable operators recover their costs including a reasonable profit. This will result in rates comparable to those that would exist in a competitive environment, thus subjecting a reasonable amount of equipment to a standard that furthers Congress' intention."); 47 C.F.R. § 76.923(a)(1) ("The equipment regulated under this section consists of all equipment in a subscriber's home, provided and maintained by the cable operator, that is used to receive the basic service tier, regardless of whether such equipment is additionally used to receive other tiers of regulated programming service and/or unregulated service.").

<sup>2</sup> Another factor that will drive increased deployment of digital set-top boxes is the desire of many cable operators to provide for digital delivery of those channels currently transmitted in analog. This desire is the product of intense competitive pressures (DBS providers currently deliver all of their services in digital, and consumers are increasingly sensitive to the quality differences between analog and digital programming), as well as the objective of reclaiming (when feasible) the valuable bandwidth that is currently devoted to analog transmission.

digital set-tops from 38 million at year-end 2004 to 63.7 million by year-end 2008. In any projection, one must also account for the tens of millions of existing set-tops that will be swapped out as some wear out, others malfunction, and millions of consumers upgrade their boxes to take advantage of additional features like DVRs, HDTV, and dual-tuners.<sup>3</sup> When the number of all these boxes is multiplied by the costs of the CableCARD (plus the additional costs for the Host interface), the costs rapidly climb into the hundreds of millions of dollars - even using Intel's deflated estimate of CableCARD costs. Thus, one need not believe that all integrated boxes will be replaced overnight with new separate security boxes to recognize that the Integration Ban would inflict economic injury on a massive scale.

4. CEA: *"Innovation and consumer choice hang in the balance."*

It is CEA, not NCTA, that wants to deny "consumer choice" to obtain an integrated set-top box. It is CEA, not NCTA, that wants the government to enforce a rule that, as Chairman Powell has said, "removes from the market a potentially cost-effective choice for consumers."<sup>4</sup> Moreover, a requirement to redesign existing set-top boxes so as to remove integrated security likely would frustrate cable's efforts to innovate toward a renewable security approach that will provide CE with the "level playing field" it is seeking while avoiding the costs and complications of CableCARDs. Integration of the renewable security functionality into consumer electronics products is likely to be more economical for operators and consumers, and it would place CE manufacturers and retailers on a totally equal footing, without requiring the physical segregation of security from other set-top box functionalities.

The notion that CE cannot innovate until the Integration Ban is imposed and operational is ludicrous. The just-completed Consumer Electronics Show ("CES") showcased thousands of innovations, from 2400 exhibitors, with over 1.5 million square feet of exhibit space. And, of particular relevance to this proceeding, the 2005 CES demonstrated that, despite the continued availability of leased integrated set-top boxes, rapid innovation continues with Digital Cable-Ready devices. These products featured picture readers, SD card inputs, various home networking interfaces, built-in DVRs, competing guides, and screen innovation in plasma, LCD, LCOS, DLP, advanced tubes, 1080 progressive scan displays, enhanced brightness, 5000:1 contrast ratios, and more. TiVo displayed a dual tuner DVR with two CableCARD slots, and announced that it will

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<sup>3</sup> The ability to exchange a set-top box for a newer model that offers more functionality is one of the reasons that many consumers welcome the opportunity to lease boxes from their cable operator - perhaps even more so during a time when services, features, and functions are changing so rapidly. The CE industry has yet to explain why consumers who wish to obtain an integrated set-top box from their cable operator (but not those who wish to obtain one from their DBS provider) should be denied the convenience of doing so.

<sup>4</sup> Commercial Availability of Navigation Devices, Reconsideration Order, 14 FCC Red 7596, 7632 (Commissioner Powell, dissenting in part)

launch in early 2006 a Cable-Ready, high-definition DVR with CableCARD slot built in that also includes a cable tuner.<sup>5</sup>

It is apparent that nothing has stopped CE innovation. And while the availability of CableCARDS may have enabled new innovations like those displayed by TiVo and those contemplated by Samsung and LG, the absence of CableCARD slots on leased set-tops has done nothing to retard innovation. Contrary to CEA's December 17 assertion that "truly innovative products that bridge content from multiple sources simply are locked out of the cable market," the availability of CableCARDS alone (and *not* the disintegration of leased set-top boxes) has enabled TiVo to develop its HD CableCARD DVR, which will not only "enable TiVo subscribers to access the growing number of high definition broadcasts available over the air or through their cable provider without a separate set-top box" but also to "access, download, and manage broadband content."<sup>6</sup>

*Cable's* ability to innovate must also be protected. Products exhibited and plans announced at CES underscore the intense, growing competition that cable faces from DBS, video-over-broadband, telephone companies and others. In response, cable has sought to strengthen its ability to compete by (among other things) embracing retail, developing and deploying OCAP, moving rapidly toward two-way interactive retail devices, and developing next-generation technology. Cable should be as free as DBS, telcos and others to direct resources into developing new features, rather than into a government-mandated redesign of existing products.

5. CEA: *"The only tangible result of more than a decade of cable compatibility negotiations and regulation is that one-way televisions are at a significant disadvantage when compared to cable operators' own leased set-top boxes."*

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<sup>5</sup> Given TiVo's announcement, one might reasonably expect that CEA would withdraw its December 17 assertion that "an innovative company like TiVo, that has been providing dual-tuner products to the satellite industry for four years, still cannot produce even this four year-old technology for the cable industry." As we pointed out in our December 20 letter (at 6-7), the cable industry fully supported TiVo's request that "CE Manufacturers should be allowed to deploy devices with dual point of deployment ('POD') interfaces and MSOs should have to supply the consumer with the appropriate number of PODs to activate dual tuner functionality," and TiVo has apparently now seized the opportunity that has been available since CableCARDS were introduced.

Incidentally, the dual-tuner capability that TiVo has offered in connection with satellite service is not a result of rules that require the even-handed treatment of CE devices but of TiVo's close relationship with DirecTV, under which dual-tuner devices are offered as *integrated* receivers for DirecTV's service. Now that DirecTV, TiVo's main distribution partner, has announced plans to market a new DVR (with "in house" News Corp. NDS technology) that will compete against TiVo's, *see DirecTV Launches Non-TiVo Digital Recorder*, Washington Post, January 6, 2005, the time may soon come when (thanks to CableCARDS) the "retail availability" of dual-tuner TiVos will be an option for cable customers, but not for DBS customers.

<sup>6</sup> Press Release, *TiVo Developing High-Definition, Digital Cable-Ready DVR; TiVo DVR with CableCARD Will Offer Flexible, Fully Featured Platform for Accessing HD Broadcast and Broadband Content* (Jan. 6, 2005).

This is perhaps CEA's most troubling assertion. And it cannot be a casual misstatement because it was in CEA's December 17 filing as well. The "significant disadvantage" to which CEA apparently refers is that, today, leased boxes provided by cable operators can access cable's "two-way" services, and Digital Cable-Ready devices do not. But the CE companies who signed the Plug and Play Agreement agreed that solving the challenges for one-way devices was a necessary first step. That Agreement was of no small consequence; CE leaders were among those who characterized it as a "landmark," a "watershed," "historic." Under this Agreement and the rules the Commission prescribed to implement it, cable operators upgraded their headends, solved difficult integration problems, and devoted hundreds of engineering personnel, field technicians, and corporate engineers to troubleshoot problems with CableCARDS and Digital Cable-Ready devices as they appeared in consumer homes. Moreover, it was and is in the cable operator's self-interest to do so. The customer with a Digital Cable-Ready set is likely a high-end cable customer whom the operator must satisfy or lose to DBS.

The cable industry has also worked assiduously toward the success of the two-way negotiations. There are virtually no technical impediments to bringing a two-way "plug-and-play" device to market. This is evident: two manufacturers— Samsung Electronics and LG Electronics — have already signed a CableLabs license enabling them to build such two-way devices. Rather, as was to be expected with the numerous parties at the table, the issues remaining in the negotiations are primarily business issues (including content protection). As these issues are addressed, technical challenges may arise, not related to whether these devices can connect to and run cable service, but rather in support of business issues that need to be resolved. Cable continues to work with the consumer electronics industry on these issues.

The plain truth is that the relationship between the CE and cable industries is radically different than it was a decade ago (or even a few years ago). Many of these changes are ones that result from changed competitive circumstances, enlightened self-interest, and growing mutual trust — not from government mandates. Thanks to the success of the one-way negotiations to which the cable industry dedicated extraordinary levels of time and expertise (as well as to the training and customer service needed to support the successful introduction of CableCARDS), CE manufacturers that wish to make one-way cable compatible devices that incorporate all set-top box functions other than security are free to do so. Already 11 manufacturers have brought over 140 such devices to market. Meanwhile, cable operators have forged strong cross-marketing relationships with CE retailers, large and small, across the nation, and CableCARD availability for each MSO is directly supported at most major CE retailers' locations through the CableLabs'Go2Broadband system. Finally, in perhaps the most visible illustration of the changed relationships between the two industries, many senior executives from cable companies have traveled to Japan and Korea to meet directly with their CE manufacturer counterparts and negotiate mutually beneficial relationships.

In all of these respects, the cable industry has more than fulfilled the hopes and expectations of the Congress and the Commission regarding measures to ensure the commercial availability of navigation devices. To claim that the Integration Ban can be

justified because there have been few “tangible result[s over] more than a decade” is to ignore the enormous, beneficial changes that have occurred over the past several years.

6. CEA: *“Only full-scale production to service MSO devices will achieve the combination of priority, investment, and volume necessary to lower acquisition costs, achieve reliability, and generate confidence for competitive entrants and consumers. NCTA’s misguided belief that prices will remain high even after full-scale production defies the laws of economics, the marketplace, and common sense.”*

Here (and in its December 17 filing as well), CEA has jumbled together different ideas. As already shown, many substantial costs associated with CableCARDS are not hardware-related and so not subject to volume discounts. In terms of “priority,” an enforceable rule of the Commission that requires deployment of and support for CableCARDS – as well as cable operators’ own self interest – is more than sufficient to ensure that cable operators do what they are required to do.<sup>7</sup> As concerns “reliability” and “confidence,” it cannot be denied that CableCARDS work.

Competitive entrants have shown confidence in CableCARDS in many ways. Eleven manufacturers have brought over 140 different one-way products to market. Two major manufacturers – Samsung and LG Electronics – have signed a license agreement with CableLabs for two-way products. Time-Warner, Charter, and Advance Newhouse have formed strategic partnerships with Samsung to rapidly introduce interactive retail devices to the market.

To the extent that CEA may be trying to imply that a ban on integrated security is the only way that *consumers* will have the “assurance” that retail devices will work, the simple fact is that different CE manufacturers will inevitably make different design decisions. As the New York Times explained, “different TV makers have designed their CableCARD slots with different degrees of gracefulness.” The consequence is that (as we explained in our January 4 letter, at note 6) “the same CableCARD from the same cable operator will sometimes work ‘flawlessly’ in one manufacturer’s device but not in another’s.”<sup>8</sup> Imposing the Integration Ban would do nothing to change this; requiring

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<sup>7</sup> It bears emphasis that CEA is essentially demanding a “belt-and-suspenders” approach to regulation. Under CEA’s view, it is not enough to require that cable companies make CableCARDS available to consumers who buy suitably designed consumer electronics products or that cable operators – by FCC rule—make those CableCARDS work with CE devices. The CE assumption that cable companies will not comply with these rules unless their own set-top boxes are also required to be redesigned to connect in the same way is belied by the efforts the industry has put into making Digital Cable Ready devices work, cable’s own self-interest in keeping its own customers satisfied, and the legal imperative that cable operators comply with FCC rules. The rules are on the books; cable operators are complying with them; and the Commission’s ability to enforce its rules cannot be questioned.

<sup>8</sup> See David Pogue, *Streamlined Cable TV in a Card*, The New York Times (Dec. 30, 2004). Since the same CableCARD from the same cable operator worked perfectly with one DTV set, but not with another, there is not much more the operator could have done to assure the “reliability” of that second set – even if the operator itself had been using CableCARDS in its leased boxes. CE manufacturers are

that cable operators' own devices be dis-integrated adds cost but adds no assurance that each CE product will operate successfully. Nonetheless, consumer confidence will grow as cable operators continue to meet their obligations under the rules, the Commission continues to enforce its rules, and consumer electronics manufacturers and retailers manufacture and market products that interoperate successfully with the CableCARD.<sup>9</sup>

7. CEA: *"Further, any recognition of the prospective benefits of investment in competitive products, by competitors, is not apparent anywhere in this or any of NCTA's filings."*

The cable industry is keenly aware of the benefits of investment in competitive products by competitors. This is why the cable industry has and will continue to work closely and cooperatively with CE manufacturers and retailers – through continued support for the one-way CableCARDS, through continued efforts to negotiate a two-way agreement, through bilateral commercial relationships at the manufacturing and marketing levels, and so on. What the cable industry resists is a requirement that precludes our customers from obtaining an integrated box if that is what they want, and instead requires them to pay for functionalities that they do not need. As noted above, they have no need for the portability that CableCARDS make possible because leased boxes are not taken out of the franchise area.

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Nothing in the recent CE filings strengthens the case for preserving the Integration Ban. This ban is unnecessary; it will saddle consumers with new costs and restrict their freedom; and it will unfairly burden cable in relation to other distributors of video programming. We continue to urge that it be eliminated now; or, at a minimum, delayed so we can further demonstrate that cable operators are making CableCARDS work with retail devices, if that is not already clear.

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highly competitive with one another, and they implement their features in non-standardized, unique ways. Every line of DTV sets therefore ships with subtleties of features, firmware, and software that are "self-verified" by the DTV manufacturer and creates its own unique sets of roll out issues that need to be overcome. The CableCARD and the interface are clearly "working," because the cards are working in more than 10,000 sets made by a variety of manufacturers. Therefore, imposing the Integration Ban on cable operators and customers will do nothing to satisfy what CEA describes (in its December 17 filing) as "the demanding expectations of retail consumers." The prospect for such idiosyncratic design choices by individual CE manufacturers would not be reduced by requiring that cable operators' own set-top boxes connect through a CableCARD. At best, it would add a new set of problems that would consume cable and current vendor resources that would otherwise be spent in innovation.

<sup>9</sup> CEA may mean to echo a theme that has appeared in some of its members' filings. There it is suggested that the costs to consumers of leasing a set-top box from a cable operator must be driven higher so as to make consumers more willing to buy consumer electronics products that incorporate set-top box functionalities. But there is no evidence that the monthly rental cost of a set-top box or of a CableCARD has any effect on the decision of a consumer contemplating the purchase of a \$1,000 HDTV set (even if the Commission were to ignore the profoundly anti-consumer impact of forcing cable to incur hundreds of millions of dollars in unnecessary costs for leased boxes).

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If you have any further questions, please contact me.

Sincerely,

**/s/ Neal M. Goldberg**

Neal M. Goldberg

cc: Marlene H. Dortch, Secretary, for inclusion in CS Docket No. 97-80  
Chairman Michael Powell  
Commissioner Kathleen Abernathy  
Commissioner Kevin Martin  
Commissioner Michael Copps  
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